ST 99-14
Tax Type: **Sales Tax**
Issue: **Bearing The Burden for Payment of Tax (Claim Issues)**
Statute of Limitations Application
Books and Records Insufficient
Non-Filer (Failure To File Returns – Extends Limit)

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	**Docket #**	**93-ST-0000**
	)	**Docket #**	**94-ST-0000**
v.	)		
"ABC GARAGES, INC." and "XYZ GARAGES, INC.",	)	**Barbara S. Rowe**	
Taxpayers	)	**Administrative Law Judge**	

RECOMMENDATION FOR DISPOSITION

Appearances: Wayne R. Golomb, Attorney at Law for "ABC Garages, Inc." and "XYZ Garages, Inc."; Mark Dyckman, Special Assistant Attorney General, for the Illinois Department of Revenue; and Joseph McMenamin, Dunn & McMenamin, representing "PDQ Garages, Inc."

Synopsis:

This matter comes on for hearing pursuant to the timely protests of "ABC Garages, Inc." and "XYZ Garages Inc." (hereinafter collectively referred to as the "Taxpayers") to two Notices of Tax Liability issued by the Illinois Department of Revenue (hereinafter referred to as the "Department.") The taxpayers agreed to consolidate the cases because the legal issues are the same, the same auditor of the Department conducted both audits, and many of the facts apply to both taxpayers. The taxpayers are "dealers" and construction contractors that purchase garage kits from their parent company, "PDQ Garages, Inc." of "Smallville", Illinois. (hereinafter referred to as "Smallville.") "Smallville" refers to owners of distributorships as dealers. The

issues in this matter are: 1) whether the Department failed to establish a *prima facie* case at the hearing; 2) whether the statute of limitations bars the Department from assessing tax on kits purchased by the taxpayers prior to January 1, 1989; 3) whether the Department mistakenly calculated the credit due to taxpayers on the garage kits; 4) whether the Department is barred from proceeding against the taxpayers regarding their miscellaneous purchases from Illinois retailers; 5) whether or not tax was correctly imposed on the purchase of a truck by "ABC Garages, Inc."; 6) whether the amounts of "$6,113.76 and $4,917.19 are taxable displays or a purchase of a business in real estate;" 7) whether Use Tax can be assessed against the taxpayers when the taxpayers' vendor remitted an incorrect lesser amount of tax on the transactions than was actually due; and 8) whether a penalty was properly imposed against the taxpayers. Following the submission of all evidence and a review of the record and briefs filed herein, it is recommended that the Notices of Tax Liability be amended to reflect the credit adjustments made at the hearing and then finalized as amended.

Findings of Fact:

1. The prima *facie case* of the Department against "John and Jane Doe" doing business as "XYZ Garages, Inc." at "1111 N. 31st Street", "Midville", Illinois (hereinafter referred to as "Midville") was established by the admission into evidence of the Certificate of Records and Correction of Return, form SC-10, for the audit period of June 1, 1984, through February 28, 1993, issued to "Midville" on June 23, 1993. The correction of return was admitted under the Certificate of Records signed by the Director of the Department. The exhibit established a tax liability of $55,393.00, penalty in the amount of $16,192.00, for a total liability of $71,585.00. The amount does not include statutory interest. (Dept. Grp. Ex. No.1; 9/11/98 Tr.[1] pp. 30-33)

2. The prima *facie case* of the Department against "Richard and Rebecca Doe" doing business as "ABC Garages, Inc." at "1111 Bailey Drive", "Largeville", Illinois (hereinafter

[1] For purposes of this recommendation, the transcript of the proceedings held on September 11, 1998, is shown as "9/11/98 Tr."

referred to as "Largeville") was established by the admission into evidence of the Certificate of Records and Correction of Return, form SC-10, for the audit period of June 1, 1984, through February 28, 1993, issued to "Largeville" on January 3, 1994. The correction of return was admitted under the Certificate of Records signed by the Director of the Department. The exhibit established a tax liability of $133,199.00, penalty of $38,525.00, for a total liability of $171,724.00. This amount does not include statutory interest. (Dept. Grp. Ex. No.2; 9/11/98 Tr. pp. 33-36)

3. "Peter Piper" created "Piper Builders" of "Smallville", Illinois in September 1952 to manufacture prefabricated garage kits. The walls, gable ends, rafters, and soffits were all pre-cut. When a garage was erected, it was necessary to assemble the pre-cut parts, apply the sheeting and roofing materials, and hang the doors to complete the garage. (9/11/98 Tr. pp. 41-44)

4. In 1957 "Smallville" expanded its business. The business began in "Midville" in 1957 and in "Largeville" in 1958. (9/11/98 Tr. p. 44)

5. "Peter Piper" established a price list for the different sized garage kits. Sales tax was not separately stated on the invoices for the kits. (9/11/98 Tr. pp. 52-60, 78, 80-85, 95-99; Taxpayer's Ex. No. 4)

6. No documents or other credible evidence was presented to establish how "Peter Piper" arrived at the cost of the kits. (9/11/98 Tr. pp. 53-67, 75-85; 9/17/98 Tr.[2] pp. 67-70; 9/18/98 Tr.[3] pp. 10-16, 20-31, 40-49)

7. A "standard" garage kit was for a garage that measured 24' X 24'. The cost of that kit was $2,430.00. It was the standard kit for a 2-car garage and the most popular model sold. (9/11/98 Tr. p. 53; 9/17/98 Tr. p. 67-68)

[2] For purposes of this recommendation, the transcript of the proceedings held on September 17, 1998, is shown as "9/17/98 Tr."

[3] For purposes of this recommendation, the transcript of the proceedings held on September 18, 1998, is shown as "9/18/98 Tr."

8. "Smallville" constructed garages for its customers as well as sold garage kits to its dealers. A kit that was sold to the dealers contained the same materials that were used by "Smallville" when it constructed the garages for its customers. (9/11/98 Tr. p. 113)

9. Prior to the 1992 audit, for purposes of tax liabilities to the Department, "Smallville" self-assessed Use Tax on "Smallville's" cost of materials for the garage kits sold to its dealers. "Smallville" never collected Retailers' Occupation Tax on the sales of garage kits to dealers. (9/11/ 98 Tr. pp. 114-115, 124-125, 142-143)

10. In 1992 "Smallville" was the subject of an audit by the Department. The audit of "Smallville" covered the period of January 1, 1989, through 1992. The Department informed "Smallville" that they should not have been paying Use Tax on the kits sold to the dealers but rather should have been charging Retailers' Occupation Tax on the kit price and listing that tax separately on the invoice. In May 1992, "Smallville" changed its method of reporting sales and began to separately state the tax charged on invoices. (Taxpayers Ex. No. 8; 9/11/98 Tr. pp. 115-133, 142-143; 9/18/98 Tr. pp. 39-40)

11. "John" and "Richard Doe" are the nephews of "Peter Piper". They began working for "Smallville" setting up garages. They subsequently became salesmen, then dealers who were given their own distributorships in 1984. (9/11/98 Tr. p. 49)

12. "John" and "Richard Doe" are construction contractors and do not engage in retail sales of garage kits. (9/11/98 Tr. p. 140; 9/17/98 Tr. pp. 64-65; 9/18/98 Tr. pp. 7-9)

13. It was up to the dealers of "Peter Piper" to take the garage kits purchased from "Smallville" and construct a garage for the dealer's customers. The completed garage was called a "turnkey garage." The cost of a turnkey garage included not only the cost of the garage kit but also the cost of construction labor, mill labor, erection labor, the concrete floor, and subcontractor labor. The percentage of cost for materials for turnkey garage is much lower than the percentage of cost for materials in a kit that a dealer purchased from "Smallville". (9/11/98 Tr. pp. 122-126)

14. After the audit of "Smallville", the Department audited "Midville" and "Largeville", the entities that are the focus of this recommendation. With respect to "Midville", the assessment is $55,393.00 of which $48,307.00 involves disputed transactions of garage kits that were purchased from "Smallville" from June 1984 through the end of 1988. Of the remaining amount of $7,086.00, $6,259.00 was the result of a sampling projection. (Dept. Grp. Ex. No. 1; 9/12/98 Tr.[4] pp. 5- 7)

15. With respect to the audit of "Largeville", the Department's assessment of $133,199.00 is composed of $113,313.00 attributable to garage kits purchased from "Smallville" from June 1984 through the end of 1988. Regarding the remaining balance of $19,886.00, during the hearing the parties agreed to a revised assessment. (Dept. Grp. Ex. No. 2; Joint Stipulation Ex. No. 2; 9/12/98 Tr. pp. 5-7)

16. During the hearing process, the parties stipulated to the amount of the credit that was to be given to the taxpayers based upon tax paid by "Smallville". The agreed formula to be used for the disputed garage kit assessments is that $1,362.88 is the agreed cost of materials. That amount was multiplied by the actual units sold by "Smallville" to the respective dealers during the time period at issue. The new number is then multiplied, this time by 5%, the Use Tax rate during the period in question. That number became the credit available, which was then reconciled with the ledgers of the two dealers in question. That reconciled number then becomes the agreed revised tax liability with respect to the garage kits purchased from the "Smallville" assessment portion of the audits at issue. (Dept. Ex. No. 3; 9/12/98 Tr. pp. 4-7; 9/17/98 Tr. p. 57)

17. The credit given to the taxpayers is for tax paid by "Smallville" to the Department on transactions with the taxpayers for the period of June 1984 through the end of 1988. The source of the basis of the credit figure of $1,362.88 came from "Smallville"'s books and records.

[4] For purposes of this recommendation, the transcript of the proceedings held on September 12, 1998, is shown as "9/12/98 Tr."

The figure is representative of the cost of materials for a kit in 1988[5]. (Dept. Ex. No. 3; 9/17/98 Tr. pp. 56-57, 62)

18. Pursuant to the stipulations, the tax liability of "Midville" is reduced to $35,224.00, of which $29,484.00 involves the garage kits purchased from "Smallville". Penalty is $2,843.00. Interest continues to accrue at the statutory rate. (Joint Stipulation Ex. No. 1; 9/17/98 Tr. pp. 5-6)

19. Pursuant to the stipulations, the tax liability of "Largeville" is reduced to $89,909.00, of which the garage kits purchased from "Smallville" constitute $71,417.00. The penalty is $7,762.00. Interest continues to accrue at the statutory rate. (Joint Stipulation Ex. No. 2; 9/17/98 Tr. p. 6)

20. Although the parties stipulated to a new credit amount at hearing, the taxpayers continue to maintain that no tax is due and to assert all issues previously identified. (9/17/98 Tr. pp. 5-7)

21. "Largeville" and "Midville" make no retail sales. They are end users of materials utilized or converted into real estate. (9/17/99 Tr. pp. 10-11)

22. The Department's auditor found that with regard to the obligations of the taxpayers that tax was due on the purchase and use of garage kits for the period of June 1984 through the end of 1988. The taxpayers were not assessed Use Tax on garage kits bought from "Smallville" from January 1, 1989, through May 1992 because those transactions were included in the audit of "Smallville" and "Smallville" was charged with the liability for those transactions. The auditor did not tax the same transaction twice. (9/17/98 Tr. pp. 13-16, 75-78)

23. The auditor gave the taxpayers full credit for taxes paid from June 1984 through the end of the audit period, February 1993, for miscellaneous items purchased from "Smallville" where the invoices separately stated the Retailers' Occupation Tax. (9/17/98 Tr. pp. 43-44, 56)

[5] The transcripts have discrepancies as to the exact figure used. The figure $1,362.88 is taken from the worksheets of the auditor of "Smallville" who took the figure from "Smallville"'s books and records. (Dept. Ex. No. 3; 9/18/98 Tr. pp. 58-60)

24. The auditor examined documents of sales to the taxpayers, some of which separately stated the tax liability and some of which did not. If the tax was separately stated, the auditor did not assess tax on that transaction. If the document did not show that tax had been paid, the auditor assessed tax. (9/17/98 Tr. pp. 47-49)

25. The auditor initially assessed two penalties on the taxpayers. The first penalty was based upon the fact that the taxpayers were non-filers. The second penalty was imposed because the taxpayers did not agree with the audit results. As a result of the revision of the audit figures as shown in the stipulations, the penalty for non-agreement with the audit figures was eliminated. (9/17/98 Tr. pp. 49-51)

26. The taxpayers were unregistered non-filers with the Department for Retailers' Occupation and Use Tax purchases at the time of the audit. (Joint Stipulation Ex. Nos. 1 & 2; 9/11/98 Tr. p. 182; 9/17/98 Tr. pp. 16, 55, 70-71; 9/18/98 Tr. pp. 33-37)

27. "Smallville" was registered and did file returns with the Department. (Taxpayers Ex. No. 7; 9/17/98 Tr. p. 18)

28. "Smallville" self-assessed tax on "Smallville's" cost of materials that it sold to its dealers. "Smallville" did not collect Retailers' Occupation Taxes from its dealers prior to the 1992 audit. However, on its returns submitted to the Department, "Smallville" included the cost of the sale of the dealer kits in its "Retailers' Occupation Tax Base" itemization line. The area on the returns in which to report Use Tax was blank. (Taxpayers Ex. No. 7; 9/11/98 Tr. pp. 142-152; 9/17/98 Tr. pp. 26-27)

29. "Smallville" was in the practice of issuing price lists for kits sold to its dealers. The price list effective March 1, 1994, issued after the audit of "Smallville" was concluded, contained a statement that "PRICES DO NOT INCLUDE SALES TAX." (Taxpayers Ex. Nos. 4, 9; 9/11/98 Tr. pp. 134-138)

30. At the hearing, taxpayers also submitted price lists effective January 1, 1993,[6] February 28, 1991, March 15, 1990, September 1988, and September 22, 1986. None of those

[6] It should be noted that the price list effective 1/1/93 came after the audit of "Smallville".

price lists contained the above statement, nor did they contain any information that sales tax was or was not included in the prices. (Taxpayer Ex. Nos. 4 & 9)

31. The price lists submitted did not correspond with the prices shown on the invoices submitted[7]. (Taxpayers Ex. Nos. 8 and 9)

32. The taxpayer submitted invoices for sales of garage kits to "Midville" from "Smallville" for 1992. (Taxpayer Ex. No. 8)

33. The invoices submitted showed the same amount charged for kits for a 16' X 22'[8] garage, a 24' X 24'[9] garage, a 24' X 28'[10] garage, and a 24' X 40'[11] garage. The prices on the two invoices submitted for the purchase of a 14' X 26'[12] garage kit were not the same, nor were the prices identical for the two invoices submitted for the purchase of a 24' X 30'[13] garage kit. Again, the price amounts do not correspond with the prices listed on the price lists submitted.[14] The invoices were representative of both taxpayers and all dealerships in Illinois at that time. (Taxpayers Ex. Nos. 8, 9; 9/11/98 Tr. pp. 133-138)

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[7] For example, Invoice #3578, dated 3/11/92 has a kit price of $1,822.80 for a 16'X 20' garage. The price list effective 2/28/91 has kit prices of $1,555.00 (for a standard) or $1,860.00 (for a vinyl) garage kit that is 16' X 20'. The next dealer price list submitted was effective on January 1, 1993, and had dealer kit prices of $1,785.00 (standard) and $2,065.00 (vinyl) for a 16' X 20' garage door kit. None of the prices shown on the two price lists corresponds with the $1,822.80 amount shown on the invoice.

[8] A 16' X 22' kit cost $1,950 <$75.07 > $1,875.00 pursuant to invoice #4353 dated 11/3/92 and invoice #4028 dated 7/14/92. The testimony was that the tax was deducted from the price of the kits and then separately stated at the bottom of the invoice after the audit. Tax was shown as added in at the bottom of these two invoices.

[9] A 24' X 24' kit cost $2,567.60 <$95.33> $2,472.27 according to invoice #4164 dated 8/31/92; invoice #4413 dated 12/1/92, invoice #4306 dated 10/21/92, and invoice #4145 dated 8/24/92. It is interesting to note that there were 4 invoices submitted for this size garage and all had the same prices shown for the kits. A 24' X 24' garage kit is the "standard."

[10] A 24' X 28' kit cost $2,844.40 <$95.33> $2,749.07 according to invoice #4125 dated 8/14/92 and invoice #4428 dated 12/7/92.

[11] A 24' X 40' kit cost $3,674.80 <$95.33> $3,579.47 according to invoice #3954 dated 6/10/92 and invoice #4450 dated 12/17/92.

[12] A 14' X 26' kit cost $1,960.00 <$72.82> $1,887.18 according to invoice #4178 dated 9/8/92 or $1,974.40 <$77.76> $1,896.24 per invoice # 3933 dated 6/2/92.

[13] A 24' X 30' kit cost $2,821.70 according to invoice 3644 dated 4/14/92 or $2,982.80 <$95.33> $2,887.47 per invoice #3904 dated 5/26/92.

[14] The price list effective 2/28/91 had dealer prices for kits as follows: 16' X 22' (standard) $1,615.00, (vinyl) $1,925.00; 24' X 24' (standard) $2,160.00, (vinyl) $2,485.00. The other size garage kits mentioned in this finding of fact are not included in the 2/28/91-price list. Price list effective 1/1/93 had dealer prices for kits as follows: 16' X 22' (standard) $1,850.00, (vinyl) $2,155.00; 24' X 24' (standard) $2,550.00, (vinyl) $2,870.00. Again, the other size kit prices mentioned in the finding of fact are unavailable on the dealer list. It should also be noted that all the other kit prices shown on the invoices submitted did not match the amounts shown on the price lists, when available. (*See* Taxpayer's Ex. Nos. 8 & 9)

34. Invoice No. 3644 was for a 24' X 30' garage kit sold by "Smallville" to "Midville" on April 14, 1992, for $2,821.70. Tax was not separately stated on the invoice. (Taxpayers Ex. No. 8; 9/11/98 Tr. p. 128)

35. Invoice No. 3904 was for a 24' X 30' garage kit sold by "Smallville" to "Midville" on May 26, 1992 for $2,982.80 with a deduction of $95.33 making the price of the kit $2,887.47[15]. Tax on the entire transaction in the amount of $169.72 was separately stated at the bottom of the invoice. (Taxpayers Ex. No. 8; 9/11/98 Tr. p. 129)

36. "Largeville" submitted invoices for 1985-1989 for 24' X 24' garage kits. The price shown on each invoice from "Smallville" was $2,430.00. (Taxpayers Ex. No. 17; 9/18/98 Tr. pp. 16-17, 22-29, 31-33)

37. At the audits conducted in calendar year 1993, the Department gave "Midville" and "Largeville" credit for taxes paid on materials in the kits. The credit given equaled 23.578% of the cost of the kits. The 23.578% figure was given to the Department by the comptroller of "Smallville" who indicated it was the figure used to calculate the amount of tax paid to the Department on "Smallville"'s cost of materials when a "turnkey garage" was completed by "Smallville". (9/11/98 Tr. pp. 16, 108, 121, 145-148; 9/17/98 Tr. pp. 9-10)

38. The parties stipulated to revised assessments that support the fact that the 23.57% figure was not indicative of the cost of the materials in a kit sold to a dealer at the time period in issue. (Joint Stipulations 1, 2; 9/11/98 Tr. pp. 121-122, 145-149; 9/17/98 Tr. pp. 21-23)

39. The Department conducted an audit of "Midville" covering the period of 1984 through the end of February 1993. The audit took place in 1993. (9/11/98 Tr. pp. 159; 9/17/98 pp. 9-10)

[15] The difference of the price of the same size garage kit sold on April 14, 1992, and May 26, 1992, is either $161.10 or $65.77 higher in May. The amount of $161.10 is the difference of the selling prices of $2,982.80 and $2,821.70. If the tax credit of $95.33 shown on the May invoice #3904 is added to $65.77 the difference is $161.10. The dealer price list effective for that period is apparently the list effective 1/1/91. There is no price listed for a 24' X 30' garage kit. The comparison of the invoices and price lists do not support the taxpayer's contention that taxes were included in the prices of the kits because there is no uniformity in the pricing of the kits.

40. At the audit of "Midville", the auditor looked at general ledgers, depreciation schedules, cancelled checks and/or check stubs, account payable invoices, and filed Income Tax returns. There was nothing in the books and records to indicate that Retailers' Occupation Tax or Use Tax was paid on the transactions involving garage kits "Midville" purchased from "Smallville". (9/17/98 Tr. pp. 55-56, 82)

41. During the audit, in addition to the purchases made by "Midville" from "Smallville", the auditor assessed Use Tax on purchases "Midville" made from Illinois suppliers who did not charge "Midville" tax on the transaction. (9/11/98 Tr. pp. 160-165)

42. The Department conducted an audit of "Largeville" covering the period of 1984 through 1992. (9/11/98 Tr. pp. 169-170)

43. At the audit of "Largeville", the auditor looked at general ledgers, depreciation schedules, check registers, account payable invoices, and filed Income Tax returns. There was nothing to indicate that Retailers' Occupation Tax or Use Tax was paid on the transactions involving garage kits sold by "Smallville". (9/17/98 Tr. pp. 55-56)

44. As a result of the audit, the Department assessed Use Tax on purchases of garage kits and office kits sold to "Largeville" by "Smallville" during the period of 1984 through 1988. No tax returns had been filed by "Largeville" with the Department. It was "Largeville"'s accountant's impression that the garage kits were a unit and that the tax had been paid to "Smallville" when the kit was purchased. (9/11/98 Tr. pp. 170-178)

45. There was no tax separately stated on the invoices for the garage kits; nor was there anything in "Largeville's" general ledger to indicate that Retailers' Occupation Tax or Use Tax had been paid to "Smallville" for the purchases. (9/18/98 Tr. p. 40)

46. The Department's auditor also assessed Use Tax on purchases made by "Largeville" from Illinois suppliers where it could not be established that any tax had been paid by "Largeville" on the transaction. Again, the accountant for "Largeville" was under the impression that the tax had been paid as part of the unit price. Tax was not stated on the invoices. The purchases were used and consumed by "Largeville" in the course of its business.

The portion of the audit regarding purchases from Illinois suppliers was done as a projection with one year's tax liability as the basis of the projection for other years. (Taxpayer's Ex. No. 11; 9/11/98 Tr. pp. 171- 183, 190-195; 9/18/98 Tr. p. 37)

Conclusions of Law:

The Retailers' Occupation Tax Act and related tax acts are authorized pursuant to Article IX Sections one and two of the Illinois Constitution of 1970. Those sections of the Constitution state:

> § 1. State Revenue Power
>
> The General Assembly has the exclusive power to raise revenue by law except as limited or otherwise provided in this Constitution. The power of taxation shall not be surrendered, suspended, or contracted away.
>
> § 2. Non-Property Taxes-Classification, Exemptions, Deductions, Allowances and Credits
>
> In any law classifying the subjects or objects of non-property taxes or fees, the classes shall be reasonable and the subjects and objects within each class shall be taxed uniformly. Exemptions, deductions, credits, refunds and other allowances shall be reasonable.

Pursuant to the constitutional authority, the legislature enacted the Retailers' Occupation Tax Act, Ill. Rev. Stat. ch 120, par. 440 *et seq.*, and the Use Tax Act, Ill. Rev. Stat. 439.1 *et seq.*, the tax acts pertinent to the discussion herein. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. Ill. Rev. Stat. ch. 120, para. 439.3[16]

The first issue to address is whether the Department established a *prima facie* case at the hearing.

[16] The tax periods at issue herein are 6/1/94-2/28/93 for "Midville" and "Largeville". Public Act 87-1005 directs that, effective January 1, 1993, the laws of Illinois will be compiled and known as the Illinois Compiled Statutes or **ILCS**. Prior to this date, the Retailers' Occupation Tax Act was found at Ill. Rev. Stat. ch. 120, par. 440 *et seq*. and the Use Tax Act was at Ill. Rev. Stat. ch. 120, par. 439.1 *et seq.* They are now respectively found at 35 **ILCS** 120/1 *et seq*. and 35 **ILCS** 105/1 *et seq.* I shall refer to the pertinent Ill. Rev. Stat. provision unless it is materially different under the present citation and that difference is relevant to this cause.

Over the objection of the taxpayers, the Certificate of Records signed by the Director of the Department and the Certificate of Records and Correction of Return form SC-10 for each of the taxpayers were admitted into evidence. Ill. Rev. Stat. ch. 120, par. 443 provides, with regards to the examination and corrections of returns that:

> . . . the Department shall . . . correct such return according to its best judgment and information, which return so corrected by the Department shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax due as shown therein. . .
>
> * * *
>
> . . . Proof of such correction by the Department may be made at any hearing before the Department or in any legal proceeding by a reproduced copy of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. Such reproduced copy shall without further proof, be admitted into evidence before the Department or in any legal proceeding and shall be prima facie proof of the correctness of the amount of tax due, as shown therein[17].

The taxpayers aver in their brief that the Department has failed to establish a *prima facie* case because: the correction of returns fail to identify the information used by the Department; that statements therein are unverified; that the forms have indecipherable signatures; that the format of the form is generally that of a spreadsheet; and that there is no evidence to show that the documents were prepared under oath or affirmation. Regarding the certification of record under which the corrections of returns were offered, taxpayers complain that there was no evidence presented by the Department: that the persons signing as the Director had any legal authority to do so; that there is no claim in the certification that any of the information is true, accurate, correct or valid, and that because of these reasons, the Department has not established a *prima facie* case based upon its best judgment and information. In furtherance of this last argument, the taxpayers cite to the fact that the liabilities at issue were reduced during the hearing.

To support these arguments, taxpayers rely on Grand Liquor v. Department of Revenue, 67 Ill.2d 195 (1976) for defining what the Department must minimally do to satisfy the

[17] This section of the Retailers' Occupation Tax Act is incorporated into the Use Tax Act at Ill. Rev. Stat. ch. 120 para. 439.12.

requirement that the Department use its best judgment and information to establish the *prima facie* case**.** Grand Liquor involved a computer generated printout relied upon by the Department, at hearing, to establish the correctness of the amount of tax due. In remanding the matter to the Department for a new hearing, the Supreme Court determined that the Department did not sufficiently lay the proper foundation for the records upon which the corrected assessment was founded.

Taxpayer's reliance upon Grand Liquor is without merit as they ignore the fact that, following the Grand Liquor court decision, the legislature amended the Retailers' Occupation Tax Act to specifically allow Department computer printouts to be admitted under the certificate of the Director without further proof, as long as specific language is provided in the certification. *See* Public Act 83-1416, effective September 13, 1984.

In addition, the courts have found that Grand Liquor is limited to a special situation, that of data generated by a computer program in which the auditor acknowledged that he did not know what those data were. Puelo v. Department of Revenue, 117 Ill.App.3d 260 (4th Dist. 1983 *leave to appeal denied*). That is clearly not an issue herein, as there is no factual issue involving computer printouts in this case.

The statute is very clear that a reproduced copy of the corrected return, under the certificate of the Director of Revenue, shall without further proof, be *prima facie* proof of the correctness of the amount of tax due. The statute requires nothing more than this to establish the *prima facie* correctness of the taxes shown to be due therein. The statute contains no language that mandates any additional foundation, explanation, testimony, or other evidence. In fact, the court in A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App.3d 826 (1st Dist. 1988) specifically stated that:

> Contrary to plaintiff's assertion, there is no statutory requirement that the DOR substantiate the basis for its corrected return. It is only necessary that the DOR determine a corrected return according to its best judgment and information. (Grand Liquor Co. v. Department of Revenue (1977), 67 Ill.2d 195, 367 N.E.2d 1238.) *Id.* at 832

As further support of the basic tax premise that the correction of returns, under the certification of the Director establishes the *prima facie* correctness of the tax shown thereon, the court in Rentra Liquor Dealers, Inc. v Dept. of Revenue, 9 Ill.App.3d 1063 (1st Dist. 1973, *rehearing denied*), addressed the correction of returns and the *prima facie* language found in the statute. This court found that "once the correction of returns were admitted into evidence at the hearing, the Department had established the prima facie case." *Id.* at 1068-1069. The court continued to say, citing Copilevitz v. Department of Revenue, 41 Ill.2d 154 (1968), that the statute imposes the burden upon the taxpayer to prove by competent evidence that the corrected returns of the Department are not correct and until the taxpayer makes such proof the corrected returns as made by the Department are presumptively correct. *See also* DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276 (1943), Central Furniture Mart, Inc. v. Johnson, 157 Ill.App.3d 907 (1st Dist. 1987).

Taxpayers argue that the corrections of returns at issue did not enjoy statutory *prima facie* correctness because the amount of taxes shown to be due thereon were changed at hearing. This argument is without legal foundation. At the audits of the taxpayers, the Department gave "Midville" and "Largeville" credit for taxes paid by "Smallville" on materials in the kits. The credit given equaled 23.578% of the cost of the kits. The 23.578% figure was given to the Department by the comptroller of "Smallville" who indicated it was the amount of tax paid on "Smallville's" cost of materials when a turnkey garage was completed by "Smallville".

Taxpayers admit that they were unregistered with the Department prior to the audits conducted in 1993. They had not filed returns with the Department. At the audits, the Department's auditor reviewed the taxpayers' general ledgers, depreciation schedules, accounts payable invoices, income tax returns, check registers, cancelled checks, and check stubs. Because the auditor was unable to find anything that indicated any Use Tax or Retailers' Occupation Tax was paid on the transactions involving the sales of garage kits by "Smallville" to the taxpayers, he assessed Use Tax on those purchases. For the kits purchased after January 1,

1989, no assessments were made because the audit of "Smallville" by the Department resulted in those taxes being properly paid. In addition, regarding the purchases other than the garage kits, when sales taxes were separately stated on invoices, the auditor did not assess the taxpayers taxes on those purchases.

At hearing, pursuant to testimony of the comptroller for "Smallville" as well as books and ledgers provided by "Smallville", the parties stipulated that the 23.578% figure given at the time of the audit should be adjusted. In accordance with information provided at the hearing by "Smallville", the number was changed to reflect the credit the taxpayers could use regarding the taxes paid by "Smallville". Although the taxpayers stipulated to adjusted amounts, they continue to assert that the stipulated amount is still too low, yet offer no other books, records, or other evidence to substantiate the assertion.

In Rentra, *supra*, the court also found that the taxpayer received a benefit because the Department did not increase the tax liability at the hearing. The court found that there is no prohibition in the Retailers' Occupation Tax Act of the Department determining the true and actual amount of tax due from the evidence presented. *See Ill. Rev. Stat.* ch. 120, par. 443, 444 (Department shall hold a hearing, "and pursuant thereto shall issue…a final assessment for the amount found to be due as a result of such hearing.") Thus, the *prima facie* correctness of correction of returns admitted into evidence is not affected by changes to the tax amounts shown thereon resulting from evidence at hearing.

A further basis of the taxpayer's objection at the hearing regarding the failure to establish the *prima facie* case was that the corrections of returns failed, on their face, to show that they were based upon the Department's best judgment and information. It was the attorney for the taxpayer's understanding that the law required the Department to establish a minimum standard of reasonableness before a purported corrected return or assessment can be made a matter of record. This understanding is incorrect as a matter of law.

Once the Department's *prima facie* case is challenged, the Department must show that its method of preparing the correction of returns meets a "minimal standard of reasonableness."

Puleo v. Department of Revenue, *supra.* In order to meet this standard, the auditor testified that he looked at general ledgers, depreciation scheduled, cancelled checks and/or check stubs, account payable invoices, and filed Income Tax returns. The courts have held that an examination of the taxpayer's books and records, as well as the Department's use of projections and statistical samples meet the minimal standard of reasonableness. Quincy Trading Post v. Department of Revenue, 12 Ill.App.3d 725 (4th Dist. 1973), Puleo, *supra,* and Fillichio v. Department of Revenue, 15 Ill.2d 327 (1959), A.R. Barns & Co., *supra.*

The attorney for the taxpayers also stated in his post trial memorandum of law as his objection to the admission into evidence of the corrections of returns, that the documents failed to show that they were based on the Department's best judgment and information[18]. Although in his memorandum, the attorney for the taxpayers specified that: statements in the correction of returns are unverified; that the forms have indecipherable signatures; that the format of the form is generally that of a spreadsheet; and that there is no evidence to show that the documents were prepared under oath or affirmation in his memorandum of law, he failed to raise these specific objections at the hearing. At the hearing counsel for the taxpayers objected to the admission of just numbers. In his post hearing memorandum of law he raised additional objections that were not raised at the hearing. Therefore the arguments were waived. *See* A.R. Barnes & Co. v. Department of Revenue, *supra;* Dearborn Wholesale Grocers, Inc. v. Whittler, 74 Ill.App.3d 813 (1st Dist. 1979); Diogenes v. Department of Finance, 377 Ill. 15 (1941).

I therefore find that the Department established its *prima facie* case when I admitted into evidence the corrections of returns under the certification of records signed by the Director of the

[18] To be specific, the language used at the hearing was: "I object to its introduction because it has not been shown – this document fails to show that it was made based on the Department's best judgment and information. And it's my understanding under the law, the Department is obligated to establish minimum standard of reasonableness before a purported corrected return or an assessment can be made a matter of the record.

It must also be explained – or I should say, the auditor must explain the methodology used in arriving at these numbers. As I said in my opening statement, I object to the bald introduction of numbers without any support for their introduction.

Merely certifying that this comes from the Department records does not meet the standard set in Grand Liquor v. the Department of Revenue, 67 Ill. 2d. 195; Masini v. the Department of Revenue, 60 Ill.App. 3d 11, Julio v. Department of Revenue, 117 Ill.App. 3d 260 and Central Furniture v. Johnson, 157 Ill.App. 3d 907. And lacking the proper foundation, it should not be admitted." (9/11/98 Tr. pp. 31-32)

Department of Revenue. Once the Department establishes the *prima facie* case, the burden shifts to the taxpayer to overcome it. Masini v. Department of Revenue, 60 Ill.App.3d 11 (1st Dist. 1978). I also find that the Department established that its method of preparing the correction of returns meets a minimal standard of reasonableness. Furthermore, I find that the taxpayer has not met its burden of overcoming the *prima facie* case of the Department.

The second issue is whether the statute of limitations bars the Department from assessing tax on kits purchased by the taxpayers prior to January 1, 1989. The taxpayer asserts that because "Smallville" filed tax returns on the transactions at issue, the Department is barred from assessing taxes on the taxpayers. For the pertinent years, the Department was not bound by a statutory limitation for assessing Retailers' Occupation Tax or Use Tax on a taxpayer who was a non-filer. By case law, however, the Department could only go back for assessment purposes to July 1981. Sargent and Lundy v. Sweet, 207 Ill.App.3d 888 (1st Dist. 1990). The taxpayers herein admitted that they were unregistered, non-filers.

The Use Tax Act requires persons that have recurring use tax liabilities to register with the Department. Ill. Rev. Stat. ch. 120, para. 439.10.[19] A construction contractor is taxable on his cost price of tangible personal property that he purchases and incorporates into real estate (*See* 86 Admin Code ch. I §130.2075) as construction contractors are considered to be end users of materials by converting them into real estate and therefore are liable for the tax. Lyon & Sons Co. v. Revenue Dept. 23 Ill.2d 180 (1961)

The Department has the capability of assessing either Use Tax or Retailers' Occupation Tax pursuant to the statutes. The complementary Use Tax Act and Retailers' Occupation Tax Act afford the Department the advantage of being able to collect unpaid taxes from either the seller-retailer or purchaser-user. "The obligation does remain primarily the obligation of the purchaser, however, who remains liable for the tax if the seller fails to collect it." Rosenow v.

[19] That section of the statutes stated: " . . . However, if such a user has a frequently recurring direct use tax liability to pay to the Department, such user shall be required to register with the Department on forms prescribed by the Department and to obtain and display a certificate of registration from the Department."

State of Ill., Department of Revenue, 715 F.2d 277 (Ill. 1983) *citing* Pennwalt Corp. v. Metropolitan Sanitary District, 368 F.Supp. 972, 978 (N.D.Ill. 1973) and cases cited therein.

In Klein Town Builders v. Department of Revenue, 36 Ill.2d 298 (1966) the Illinois Supreme Court held that there was no statutory proscription barring the Department from proceeding against the purchaser-user rather than the seller-retailer. *Id.* at 304. Klein Town involved a situation similar to the one before me in that Klein Town was a construction contractor making purchases from a supplier that sold materials to Klein Town.

Currently, the Use Tax Act has a six-year statute of limitations that became effective on September 16, 1994. The tax periods as well as the Notices of Tax Liability at issue predate the change in the statute. "The law in Illinois is well settled that statutes are prospective in their operation and will not be construed to have a retrospective operation unless the language used in the statute is so clear that it will admit no other construction." Quincy Trading Post v. Dept. of Revenue, 12 Ill.App.3d 725, 732 (4th Dist. 1973). There is no language in the statute regarding retrospective application and therefore the six year statute of limitations is inapplicable.

Therefore, there is no legal prohibition preventing the Department from issuing the instant assessments against these taxpayers going back to the beginning of the businesses, which in this case was 1984. Although taxpayers aver that this is incorrect, they have failed to provide any case law or statutory provision in their support.

The third issue is whether the Department mistakenly calculated the credit due to the taxpayers on the garage kits. At the audits of the taxpayers, the Department gave "Midville" and "Largeville" credit for taxes paid on materials in the garage kits. The credit given equaled 23.578% of the cost of the kits. The 23.578% figure was given to the Department by the comptroller of "Smallville" who indicated it was the amount of tax paid on "Smallville's" cost of materials when a turnkey garage was completed by "Smallville". At the hearing, the comptroller proved that the 23.547% figure was in error, and with books and records of "Smallville" established another figure based upon taxes paid by "Smallville" that the Department agreed to use as a credit against the assessed liabilities of the taxpayers. As legally

appropriate, once the Department received information, supported by books and records, that the taxpayers were entitled to an additional amount of credit, the Department gave taxpayers that credit. Copilevitz v. Department of Revenue, 41 Ill.2d 154 (1968).

Regarding any additional increase in the amount of credit allowed, there are fatal problems with taxpayers' assertions in this area. First, taxpayers' invoices and price lists are not consistent regarding the costs of the prices of the garage kits, which is discussed, *supra*. Also, the taxpayers' testimony is inconsistent as to the way "Peter Piper" arrived at the formula for the costs of the kits. The taxpayers did not provide any documentation, other than hand written notes, as to the computation of the formula by "Peter Piper".

"A taxpayer has all of his books and records, so, if wrongfully assessed, he could easily overcome the prima facie case of the department at the hearing procedures provided. In short, plaintiff may not prevail merely saying its own return was correct, and that the revenue department must prove its return correct. Simply questioning the Department of Revenue's return or denying its accuracy does not shift the burden to the Department." Quincy Trading Post, *supra*, at 730-731. In Central Furniture Mart, Inc. v. Johnson, 157 Ill.App.3d 907 (1st Dist. 1987), the Illinois Appellate Court found that sales taxes calculated on a scratch pad that was subsequently thrown away was insufficient to establish that taxes were separately stated and collected.

As a result of the above, I find that the taxpayers have not established that they are entitled to any additional credit. I therefore find that the Department did not mistakenly calculate, at the hearing, the credit due to taxpayers on the garage kits.

As the question of whether the Department is barred from proceeding against the taxpayers regarding the miscellaneous purchases from Illinois retailers, it is unclear exactly what the taxpayers argue here. A purchaser who does not pay the Use Tax to a retailer is required to file a return with the Department of Revenue and pay that tax. Turner v. Wright, 11 Ill.2d 161 (1957). If the argument is that the taxpayers purchased tangible personal property from Illinois retailers and therefore the Illinois retailers are responsible for the tax, that issue is the same as the

assertion that "Smallville" is responsible for the taxes on the garage kits and has been already discussed, *supra*. In short, there is no statutory prohibition against imposing Use Tax on purchases from Illinois retailers. The Use Tax Act falls alike upon purchases made both within the State and outside the State. The scheme of the tax is more complex than that of a Use Tax that falls only on out-of-State purchases. Turner v. Wright, *supra*.

The next two issues are whether a tax was correctly imposed on the purchase of a truck by "Largeville" and whether the amounts of $6,113.76 and $4,917.19 are taxable displays or a purchase of a business in real estate. The purchase of the truck and the amounts attributable to the transactions of $6,113.76 and $4,917.19 were not addressed at the hearing. I therefore recommend that the amounts corresponding to those transactions be upheld as stipulated to.

Issue No. 7 is whether Use Tax can be assessed against the taxpayers when the taxpayer's vendor remitted an incorrect lesser amount of tax on the transaction than was actually due. As already discussed *supra*, the Department is empowered to assess Use Tax against a purchaser if they cannot establish that the correct amount of tax has been paid on a transaction. "Smallville" asserted that they remitted self-assessed Use Tax to the Department on garage kits sold to the taxpayers for the period of 1984 through December 31, 1988. The self-assessment was based on the cost of the materials in the kits sold to the taxpayers. The correct tax that "Smallville" should have paid to the Department was Retailers' Occupation Tax on the cost of tangible personal property sold at retail. This amount is based upon the gross cost including the tax. *See* Ill. Rev. Stat. ch. 120, para. 441; Reif v. Barrett, 35 Ill. 104 (1933). If the Retailers' Occupation Tax liability is not completely and properly paid, the Department is empowered, by statute, to assess Use Tax on the purchaser. The Use Tax amount due is based upon the amount paid by the purchaser, which amount includes the tax. *See* Ill Rev. Stat. ch. 120, para. 439.3; American Airlines v. Dept. of Revenue, 58 Ill.2d 251 (1974)

Apparently it is the taxpayers' argument that since the Department collected some, albeit insufficient, tax on the transactions from "Smallville", it is barred from collecting the correct

amount of tax that the taxpayers owe on those purchases. The taxpayers failed to cite any authority to support this argument that Use Tax can not be assessed against the taxpayers when the taxpayers' vendor remitted an incorrect, lesser amount of tax on the transaction than was actually due. I find no support, either statutory or through case law, that bars the Department from collecting the correct amount of tax due on a transaction.

The final issue is whether a penalty was properly imposed against the taxpayers. The auditor initially assessed two penalties on the taxpayers. The first penalty was based upon the fact that the taxpayers were non-filers. The second penalty was imposed because the taxpayers did not agree with the audit results. As a result of the revision of the audit figures as shown in the stipulations, the penalty for non-agreement with the audit figures was dropped. Therefore the only penalty assessed was because the taxpayers were non-filers. In its brief, counsel for taxpayers states, in regard to the imposition of the penalty at issue:

> The Department has advanced neither a factual or legal basis for the imposition of a penalty. The record is simply devoid of any basis to show why the penalty listed in Department's Exhibit I and II or Joint Stipulation Exhibits is being imposed. The documents merely show numbers. Moreover, there is no evidence of record to support a penalty assessment. All that is before the hearing officer is numbers. Before a penalty can be imposed, there must be a factual and legal basis for its imposition. The Department has totally failed to provide a basis for the imposition of a penalty, and any penalty should be stricken. (Taxpayer's 11/20/98 Argument p. 27)

The statutory authority to impose a penalty for the failure to file a required tax return is found at Ill. Rev. Stat. ch. 120, para. 444. The penalty imposed is 10% of the amount of tax due. In stating that there is no factual basis for imposing the penalty, taxpayers' counsel fails to account for the four days of testimony taken in this matter. He fails to take into account the numerous exhibits submitted, and in particular, fails to take into account the taxpayers' admissions that they were not registered with the Department and did not file returns with the Department. Therefore, a plain reading of the record in this matter establishes a factual basis for the penalty imposed pursuant to a statutory provision.

Although the statute provides for an abatement of the penalty for reasonable cause, the taxpayers have not asserted any reasonable cause why the penalty should be abated. A taxpayer's mistaken belief that it was not liable for Use Tax is not sufficient to justify failure to pay the tax or resist the imposition of a penalty for non-payment. Columbia Quarry Co. v. Dept. of Revenue, 40 Ill.2d 47 (1968). I therefore find that the penalty was properly imposed.

WHEREFORE, for the foregoing reasons, it is recommended that the assessments at issue be upheld, as amended with the adjustments that were made during the hearing.

Respectfully Submitted,

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Barbara S. Rowe
Administrative Law Judge
July 30, 1999